AIFMD Factsheet

AIFMD – Delegation

Introduction

The Alternative Investment Fund Managers Directive ("AIFMD"), allows alternative investment fund managers ("AIFMs") to alternative investment funds ("AIFs") to delegate the carrying out of functions to eligible third parties, subject to certain requirements and limitations.* AIFMD provides that the AIFM should not be hindered to act in the best interests of investors in an AIF as a result of any such delegation and that it must remain responsible for the delegated functions.

Delegation Conditions

An AIFM may delegate functions subject to the following provisions:

(i) The AIFM must be able to justify the entire delegation structure on objective reason (e.g. in order to increase the efficiency of the conduct of the AIFM’s business);
(ii) The delegate must be sufficiently resourced to carry out the delegated functions and the individuals within the delegate must be of good repute and have sufficient experience;
(iii) Where the delegation concerns portfolio management or risk management, it must be assigned only to third parties who are subject to authorisation or registration for the purposes of asset management and subject to prudential supervision. In addition, co-operation agreements must be in place between the home Member State of the AIFM and the relevant supervisory authority of the delegate where the delegate is located in a non-EU third country;
(iv) The AIFM must be able to demonstrate that the delegate is qualified and capable of undertaking the functions in question, that it was selected with all due care and the AIFM is in a position to monitor effectively at any time the delegated activity, to give further instructions and to withdraw the delegation with immediate effect when this is in the interests of investors;
(v) The services of the delegate must be reviewed on an on-going basis; and
(vi) Neither portfolio management nor risk management may be delegated to the depositary.

* The delegation requirements and limitations apply initially to all authorised AIFMs. They will not apply to non-EU AIFMs until 2015 at the earliest.
Letter Box Entity

The AIFM must not delegate functions to the extent that it becomes a ‘letterbox entity’.

The Level 2 Regulations issued by the European Commission and which form part of the implementing instruments for AIFMD provides further clarification in relation to the conditions that may cause an AIFM to be considered a letterbox entity pursuant to AIFM.

The Level 2 Measures provides that a delegation in the circumstances listed below, will cause an AIFM to be considered to be a letter-box entity:

(i) The AIFM no longer retains the necessary expertise and resources to supervise the delegated functions effectively and manage the risks associated with the delegation;
(ii) The AIFM no longer has the power to take decisions in key areas which fall under the responsibility of senior management or to perform senior management functions;
(iii) The AIFM does not have or loses the right to inspect, obtain information from, have access or give instructions to its delegates; and
(iv) Where the AIFM delegates the performance of its investment management functions to an extent that exceeds, by a substantial margin, the investment management functions performed by the AIFM itself.

However, in addition to the quantitative tests listed above, when considering whether an AIFM should be considered to be a letter-box entity, the Level 2 Measures also provide for a qualitative test that local regulators must also consider when assessing the delegation framework, which includes consideration of the following criteria:

(i) The AIF’s assets and the importance of the assets delegated to the AIF’s risk/return profile;
(ii) The importance of the assets under delegation to achieving the AIF’s investment objectives;
(iii) The geographical and sectoral spread of the AIF’s investments;
(iv) The risk profile of the AIF;
(v) The AIF’s investment strategies;
(vi) The types of tasks delegated versus those that are retained; and
(vii) The configuration of delegates and their sub-delegates, their geographical sphere of operation and their corporate structure including whether the delegation is conferred on an entity belonging to the same corporate group as the AIFM.

This compromise is a positive development and indicates that the qualitative criteria may also be considered, rather than the more restrictive quantitative test originally proposed. As a result the delegation model operational in countries such as Ireland may continue to be used. Click here to view the Implementation in Ireland factsheet.

Sub-Delegation

Sub-delegation is also permitted subject to (i) the prior consent of the AIFM; (ii) prior notification to the relevant competent authority; (iii) the sub-delegate meeting the delegation requirements sets out below; (iv) the portfolio management or risk management not being delegated to the depositary or delegate of the depositary; and (v) the relevant delegate reviewing the services of the sub-delegate on an on-going basis.

Programme Of Activity

All authorised AIFMs are required to prepare a programme of activity setting out how it intends to comply with the AIFMD for each AIF they manage. This includes details of the AIF’s delegation model and the processes and procedures around this model. The programme of activity must provide details in relation to the following with respect to delegation arrangements:
(i) The lists of reports to be received by the designated person from the delegate;
(ii) The frequency of such reports to be received from each delegate which must provide for the immediate reporting of all material issues that arise; and
(iii) Examples of circumstances in which action is required by the designated person, including escalation of issues to the Board of the AIF.

Liability
The liability of the AIFM to each AIF is not affected by virtue of any delegation arrangement or any further sub-delegation.

Conclusion
The Commission will monitor the application of these rules and in two years may outline further changes if it deems necessary. The European Securities and Markets Authority ("ESMA") may issue guidelines to ensure a consistent assessment of the delegation regime across the EU.